3126

No._____

# In the United States
# Circuit Court of Appeals
## FOR THE NINTH CIRCUIT.

JAMES A. MURRAY,

*Appellant,*

vs

H. E. RAY, as Trustee of the Estate of Alec Murray, Bankrupt,

*Appellee.*

## ADDITIONAL AND SUPPLEMENTAL BRIEF ON BEHALF OF APPELLANT.

Appearances for Appellant:

JAMES E. MURRAY,
J. BRUCE KREMER,
L. P. SANDERS,
ALF C. KREMER, of Butte, Montana.

Appearance for Appellee:

J. M. STEVENS, of Pocatello, Idaho.

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## ADDITIONAL AND SUPPLEMENTAL BRIEF ON BEHALF OF APPELLANT UPON APPEAL FROM THE UNITED STATES DISTRICT COURT, FOR THE DISTRICT OF IDAHO

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### ARGUMENT.

With the permission of the court we submit the following in addition to and supplemental of the brief heretofore filed for and on behalf of appellant and so far as may be possible shall endeavor to avoid repetition of matters therein contained.

This action is one to set aside a deed of convey-

ance upon the ground of fraud. It was executed by Alec Murray within the period of four months before the filing of the petition for adjudication in bankruptcy and delivered to appellant and placed on record, and the gist and essence of the petition is that it was so executed and delivered "with the intent to hinder, delay and defraud the creditors of the said Alec Murray, bankrupt." (Paragraph VIII of the petition, page 10.)

The provision of the federal act of bankruptcy under which the action proceeds, is Section 67 (e), which is as follows:

> "e. That all conveyances, transfers, assignments, or incumbrances of his property, or any part thereof, made, or given by a person adjudged a bankrupt under the provisions of this act subsequent to the passage of this act and within four months prior to the filing of the petition, with the intent and purpose on his part to hinder, delay, or defraud his creditors, or any of them, shall be null and void as against the creditors of such debtor, except as to purchasers in good faith and for a present fair consideration; and all property of the debtor conveyed, transferred, assigned, or encumbered as aforesaid shall, if he be adjudged a bankrupt, and the same is not exempt from execution and liability for debts by the law of his domicile, be and remain a part of the assets and estate of the bankrupt and shall pass to his said trustee, whose duty it shall be to recover and reclaim the same by legal proceedings or otherwise for the benefit of the credit-

ors. And all conveyances, transfers, or incumbrances of his property made by a debtor at any time within four months prior to the filing of the petition against him, and while insolvent, which are held null and void as against the creditors of such debtor by the laws of the State, Territory or District in which such property is situate, shall be deemed null and void under this act against the creditors of such debtor if he be adjudged a bankrupt, and such property shall pass to the assignee (trustee) and be by him reclaimed and recovered for the benefit of the creditors of the bankrupt. For the purpose of such recovery any court of bankruptcy as hereinbefore defined, and any state court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction."

It is not a proceeding wherein a trustee seeks to have a transfer adjudged to be a preference and the distinction between these two kinds of action is clearly pointed out in the case of Van Iderstine v. National Discount Bank, 174 Fed. 518, wherein it is said:

> "A 'preference' and a 'fraudulent transfer' of a bankrupt's estate within the bankruptcy act are not the same. In a preferential transfer the fraud is technical and consisting in the infraction of the rule of equal distribution among all creditors, which it is the policy of the court to enforce when all cannot be fully paid; while in a fraudulent transfer the fraud is actual, in that the bankrupt has secured an advantage for himself out of what, in law, should belong to his creditors."

This case on appeal to the Supreme Court of the United States was affirmed, 227 U. S. 575, 57 Law Edition, 652; the decision in effect holding that the payment by a bankrupt within the four months' period of a legitimate debt is not within the judicial condemnation of the provisions of Section 67 (e) of the federal act of bankruptcy.

With respect to the well recognized distinction between technical fraud and actual fraud as pointed out in the foregoing decision, we shall hereafter deal more elaborately when we present to the court the rule unanimously adopted by the federal courts as to the character of proof demanded of a trustee in bankruptcy in a proceeding to set aside a transfer for fraud under the provisions of the bankruptcy act.

No matter how gross the fraudulent intent or conduct of the grantor, bankrupt, it is the law that the grantee may not be deprived of his property by such reprehensible acts on the part of the bankrupt.

It is held to be sufficient for the grantee to show good faith, i. e., good faith with respect to any rights of the creditors, but no one else, and in cases where the title to the property was confessedly in the grantor who sold or conveyed it, a present fair consideration. But what constitutes such consideration varies with the facts and circumstances of the particular case. Where the property admittedly belongs to the debtor adjudged a bankrupt, then the present fair consideration under the decisions must be that which the term implies and which is a matter of proof—such consideration being something of value constituting a

present fair one. But in a case, like the one at bar, where the owner—the appellant herein—owning the property, transferred it to the grantee—the bankrupt herein—for trust purposes and upon the termination of the trust re-invested himself with that which equitably at all times was his own, the present fair consideration does not require payment by the equitable owner of any substantial or even nominal consideration for the purpose of again procuring the legal title of that which at all times was his own property. Herein the bankrupt accepting the legal title of the trust property without payment therefor and having completed the purposes of the trust could not equitably demand payment to him of a substantial purchase price or a consideration approximately equivalent to the value of the property nor can the trustee or creditors equitably demand that any such showing be made by the appellant in this case. The bankrupt several years prior to the filing of the petition in bankruptcy procured the legal title to the property paying nothing for it as is usual and customary when property is transferred for trust purposes and upon the termination of the trust he transferred to his grantor, the appellant herein, such legal title. Transactions of this kind are usual and do not meet with judicial condemnation. The bankruptcy act does not contemplate that because the trustee has been adjudicated a bankrupt the actual owner must purchase his property for a substantial consideration, nor does the law remotely suggest that the creditors of

the bankrupt trustee under the trust arrangement may equitably or rightfully demand that the equitable owner shall pay "the present fair consideration" for the return of that which was always his own. Hence, herein, the trust agreement having been established, the bankruptcy law does not require that appellant show more than good faith—good faith in so far as the creditors of the bankrupt are concerned and nobody else.

Under the decisions, and first of all, the trustee herein must show the actual fraud of the bankrupt.

> "The act does not dispense with the necessity of showing to avoid a conveyance or transfer under Section 67 (e), that the bankrupt had the *actual intent* to hinder, delay or defraud creditors. What is meant when it is required that such conveyance, in order to be set aside, shall be made with the intent on the bankrupt's part to hinder, delay or defraud creditors? This form of expression is familiar with the law of fraudulent conveyances and was used as the common law, and in the statute of Elizabeth, and has always been held to require, in order to invalidate, a conveyance if there shall be actual fraud; and it makes no difference that the conveyance was made upon a valuable consideration if made for the purpose of hindering, delaying or defrauding creditors. The question of fraud depends upon the motive. Kerr, Fraud and Mistake, 196-201. The mere fact that one creditor was preferred over another or that the conveyance might have the effect to secure one creditor and deprive others

of the means of obtaining payment was not sufficient to avoid a conveyance; but it was uniformly recognized that acting in good faith a debtor might thus prefer one or more creditors. Stewart v. Dunham, 115 U. S. 61; Huntley v. Kingman Co., 152 U. S. 527. We are of opinion that Congress in enacting Section 67 (e) and using the terms 'to hinder, delay or defraud creditors' intended to adopt them in their well known meaning as being aimed at conveyances intended to defraud. In Section 60 merely preferential transfers are defined and the terms on which they may be set aside are provided; in 67 (e) transfers fraudulent under the well recognized rules of the common law and the statutes of Elizabeth are invalidated. The same terms are used in Section 3, Subdivision 1, in which it is made an act of bankruptcy to transfer property with intent to hinder, delay or defraud creditors. Such transfers have been held to be only those which are 'actually fraudulent.'"

Coder v. Arts, 213 U. S. 223;

Thompson v. Fairbanks, 196 U. S. 516.

Consequently, all that the appellant need show is good faith towards the creditors of the bankrupt only, the peculiar facts in this case disclosing the inception and termination of the trust and hence dispensing with the present fair consideration that, where a sale of property confessedly belonging to the bankrupt is shown to have been transferred, must be established as moving from the vendee or grantee.

Dooken v. Page, 147 Fed. 439;
Shelton v. Price, 174 Fed. 891;
2 Remington on Bankruptcy (2nd Ed.) Sec. 1495.

We have already invited the attention of the court to the facts herein which differ from those involved in the decisions where the property was admitted by all parties not to have been held in trust but to have been the bankrupt's own property which he conveyed away. In such a state of facts the purchaser must show the present fair consideration discussed in the cases. But where, on the contrary, the property was held by the bankrupt as trust property, the legal title thereof having been conveyed to him for the purpose of enabling him to effectuate the trust agreement, without payment of substantial consideration therefor, the present fair consideration referred to in the very nature of things need not be shown by the owner of the equitable title upon conveyance of the legal title to him for such rule would violate every principle of law and justice and impose upon the transferee the burden of buying his own property for a present fair consideration. No such principle or requirement is laid down in the books.

Reverting to the question of what constitutes good faith, it is first of all proper to keep in mind the fact that the transferee need only show good faith in the transaction so far as the creditors of the transferrer, the bankrupt, are concerned. It means that the credit-

or should not act in such a way as to *intentionally defeat the bankruptcy act,* and even though appellant were shown to have knowledge of the bankrupt's insolvency this, without more, is not enough to destroy his good faith.

2 Remington on Bankruptcy (2nd Ed.), Section 1504.

"Lack of good faith must amount to *actual fraud* to evade an avoidance of the transfer."

2 Remington on Bankruptcy (2nd Ed.), Section 1504, page 1391, bottom.

In the case of Powell v. Gate City Bank, 178 Fed. 609, it is said:

"The security given for a present loan is not avoided by the fact that it actually hinders or delays creditors by the withdrawal of the security from application to the payment of their claims unless it was given *with an actual intent to defraud such creditors and the recipient had actual or legal notice of that purpose. Actual fraud in which the recipient of the lien or security participates is indispensible to the avoidance of a transaction of this nature.*"

In the case of Bush v. Export Storage Company, 136 Fed. 918, it is said that:

"It may be affirmed to be true as a general proposition that under any state system of jurisprudence, it is necessary in order to set aside a conveyance or transfer of property as fraudulent

> as against creditors that the fraud must have been participated in by the vendee or purchaser as well as the vendor."
>
> (Page 922.)

Hence in the ultimate analysis of the act and the showing that is demanded of the trustee in bankruptcy in a proceeding of this kind there must be established first, actual fraud on the part of the bankrupt, and, second, actual fraud on the part of the appellant as against the bankrupt's creditors. And we, therefore, contend that the trial court erred in holding that appellant insofar as any creditor of the bankrupt was concerned, was guilty of any fraud whatever. Certainly as to such a creditor it is not shown by the degree of evidence essential in a case of this character that he was guilty either of bad faith or fraud, actual or constructive. He took back that which belonged to him. Having conveyed it for trust purposes without receiving consideration therefor, there was nothing illegal or contrary to good morals that he should receive it back without paying therefor when the purposes of the trust agreement had been performed. None of his acts was one of which any creditor of the bankrupt, nor the trustee in bankruptcy, has a right to complain. It was under the decisions essential to show not only actual fraud on the part of the bankrupt, but likewise actual fraud on the part of appellant as against the trustee in bankruptcy and the creditors.

Assuming, without conceding the fact, that Alec Murray represented that the Idaho property was his own, there is no evidence that he made such representations to the knowledge of appellant and such evidence is inadequate by itself under the law to justify the decree appealed from. As actual fraud of both bankrupt and appellant must be established by evidence clear and satisfactory, in the very nature of things such evidence must show a concert of action between the bankrupt and the appellant, for it is altogether an anomaly and inconceivable that between grantor and grantee or vendor or vendee, each may be guilty of actual fraud and each innocent of what the other was doing. Such a condition is wholly impossible and is inconsistent with all human relations or experience. The record is wholly silent as to any evidence of such a condition or relation existing between the bankrupt and appellant herein. That there must be evidence not only of fraud on the part of the bankrupt within the rule laid down by the decisions, but also on the part of the appellant as against the creditors necessarily must be true from a consideration of the petition itself. The action is brought against James A. Murray, the transferee. It is not an action against Alec Murray. It is alleged against James A. Murray as the defendant that the deed was given to him with the intent to hinder, delay and defraud the creditors of the bankrupt. It would violate every conception of pleading and proof to assert that in an action against A wherein such an allegation is not only

made, but necessary to be set forth and proved, the case is established by evidence in support of such allegation against B. Essentially then there must be evidence against James A. Murray of such allegation, but, as noted, evidence short of actual fraud is insufficient to prove the case against him. Where, in the record, can there be found proof of actual fraud as against the creditors of the bankrupt on the part of the appellant? We confidently assert that there is none.

It is evident that the trial court overlooked and ignored this essential fact that had to be established by clear, convincing and satisfactory evidence.

A study of the decision which is incorporated in the record discloses the fact that the trial court indulged in severe criticism of the conduct of appellant as against the State of Idaho with respect to the qualification of Water Commissioners. We respectfully submit that had appellant's conduct justified the animadversions of the trial court and had he attempted to evade or play fast and loose with the laws of the State of Idaho (a fact we do not admit), still such conduct on his part does not remotely have a bearing on the vital issue here, for it is not a question of good faith on the part of the appellant towards the State of Idaho, its laws or courts, but whether or not his conduct and acts proximately tended "to hinder, delay or defraud the *creditors of the bankrupt.*" We further contend that there is no adequate proof of the apparent finding of the trial court that appellant

presented the property in question to the bankrupt as a gift. Evidence to establish a gift must be clear and satisfactory, and we respectfully submit that the record does not present even a fair inference that appellant intended to make a present of the auditorium to the bankrupt. That evidence sufficient to establish a gift must be clear and satisfactory, see 20 Cyc. page 1246 (4) and cases. The acts of the parties themselves are inconsistent with such a theory, and so far as the rights of appellant are concerned it is not to be adjudged a gift simply because the record discloses testimony to the effect that the bankrupt asserted that the property was his, for that the appellant had any knowledge of such claim the record is silent. That the appellant transferred the auditorium to Alec Murray with the intent alleged and essential to be proved by clear and convincing and satisfactory evidence we submit that there is no proof in the record; not a scintilla of proof that the transaction ever remotely had for its purpose the defrauding of the creditors of Alec Murray and without proof of this fact the decree cannot stand. Even were it the fact that appellant transferred the property to qualify commissioners under the statutes of Idaho relative to municipal water service which the lower court apparently conceived to have been his purpose, still such fact, were it a fact, does not remotely tend to prove the vital issue here. That appellant owning the property in question, transferred the legal title to Alec Murray without consideration, for trust purposes—whether reprehensible

or otherwise, under the laws of Idaho is immaterial in an action brought by the trustee in bankruptcy upon behalf of creditors, asserting that the transaction was consummated with the intent of hindering and delaying the creditors of the bankrupt. That the equitable title was at all times in appellant, who was the actual owner thereof and that Alec Murray was a mere trustee, and that at all times so actually owning the property, it was deeded to appellant, are facts uncontroverted and uncontradicted in the record.

As pointed out in an action of this character to set aside a fraudulent conveyance, the rule as to the degree of proof essential is in no way relaxed in a bankruptcy proceeding brought by a trustee. Clear and satisfactory proof of the actual fraud as distinguished from technical or constructive fraud is necessary, and we submit that the record fails to present the adequate degree of proof required.

> "Fraud is never presumed but must be proved by clear and satisfactory evidence and will not be imputed when the facts from which it is supposed to arise are consistent with honest intentions."

Allen v. Riddell, 37 So. 680;

Eckstaedt v. Moses, 105 Ill. App. 634;

American Varnish Co. v. Reed, 87 N. E. 224;

Shumaker v. Davidson, 87 N. W. 441;

Gray v. Tollwell, 41 Atl. 869.

"Fraud is not to be lightly imputed. The law never presumes it. It devolves on him who alleges fraud to show the same by satisfactory proof."

Jones v. Simpson, 116 U. S. 609; 29 Law Ed. 742;

Jacobs v. Van Sickel, 123 Fed. 340.

"If the fraud is not strictly and clearly proved as alleged, relief cannot be obtained."

Mielshier v. McKinley, 35 S. E. 446.

The Supreme Court of the United States in the case of Coder v. Arts, 213 U. S. 223, *supra,* points out the distinction between technical or constructive fraud and actual fraud, and it is the purport of the decisions that in an action to set aside fraudulent conveyances, actual intent to defraud and actual fraud on the part of the vendor or grantor is not sufficient, there must further be evidence of actual fraud on the part of the vendee.

"Actual fraud implies deceit, artifice, trick, and design."

People v. Kelly, 35 Barb. 444.

"'Actual fraud' is a deception practiced in order to induce another to part with property or to surrender some legal title and which accomplishes the end designated."

Haas v. Sternbach, 41 N. E. 51.

Actual fraud is any cunning deception or artifice used to circumvent, cheat or defeat another.

Hatch v. Barrett, 8 Pac. 129.

"Fraud may be actual or constructive. Actual fraud consists in any kind of artifice by which another is deceived. Constructive fraud consists in any act or omission or commission contrary to legal or equitable duty, trust or confidence justly reposed, which is contrary to good conscience and operates to the injury of another. The former implies moral guilt; the latter may be consistent with innocence."

Massachusetts Ben. Life Ass'n v. Robinson, 104 Ga. 256, 30 S. E. 918, 42 L. R. A. 261.

"One who knowingly and wilfully makes full representations as to material facts with intention to induce the other to enter into a contract with him and who does so induce the other to enter into the contract to his injury, is guilty of actual fraud as regard to his intent as to injury to the other party. It is a fraud in law if the party makes representations which he knows to be false and injury ensues, although the motive from which the representations proceeded may not have been bad."

Northwestern Life Ins. Co. v. Montgomery, 43 S. E. 79, 80.

Under the provisions of the act of bankruptcy the federal decisions with complete unanimity hold that

the party seeking to set aside a conveyance given "to hinder, delay or defraud creditors" must prove this actual fraud—actual intent so to defraud as distinguished from technical or constructive fraud, and as held in the case of Bush v. Export Storage Co., 136 Fed. 918, it must be shown that this actual fraud was participated in by the vendee or purchaser as well as the vendor.

In re Maher, 144 Fed. 503, the court observes that "in a preferential transfer the fraud is constructive or technical, consisting in the infraction of that rule of equal distribution among all creditors which it is the policy of the law to enforce when all cannot be fully paid. In a fraudulent transfer the fraud is actual, etc." and as pointed out such rule has been adopted by the Supreme Court of the United States.

The following cases demonstrate that the intent to hinder, delay or defraud must be actual not presumed as a consequence of acts.

Re Eggart, 132 Fed. 735;
Lansing Boiler & Engine Works v. Ryerson, 128 Fed. 701;
Githens v. Schiffer, 112 Fed. 505;
Hark v. Allen Co., 146 Fed. 665;
Re Virginia, etc. 139 Fed. 209;
In re Bloch, 142 Fed. 674;
Davis v. Schwartz, 155 U. S. 631; 39 Law Ed. 289.

"A transfer by an insolvent within four months prior to the filing of the petition in bankruptcy

proceedings for the purpose of securing or paying a pre-existing debt without any intent to effect other creditors injuriously beyond the necessary effect of the security is lawful and does not evidence any intent to hinder, delay or defraud creditors within bankruptcy act, July 1, 1898, etc., providing that all transfers or incumbrances by a bankrupt within four months prior to the filing of a petition with the intent to hinder, delay or defraud creditors shall be void as against creditors except as to purchasers in good faith."

In re Armstrong, 145 Fed. 202;
Coder v. Arts, 152 Fed. 942; 213 U. S. 223;
53 Law Ed. 772, *supra.*

"To avoid a mortgage under Section 67 (e) as to other creditors, actual fraud in which Quinn (mortgagee) participated as distinguished from a mere preferential transfer or constructive fraud must be shown."

McAtee v. Slade, 185 Fed. 442, 451.

"It is not every intent to hinder or delay creditors . . . . . but an intent to do so unlawfully only that is denounced by that section (67 e)."

Sargent v. Blake, 160 Fed. 57.

"To avoid this transfer under section 67 (e) of the bankruptcy act it is incumbent upon complainant to show actual fraud in fact in the conveyance of the property to the deceased as distinguished from constructive fraud. Citing cases."

Meservey v. Roby, 198 Fed. 844-848.

Herein we inquire where is proof of actual fraud or actual intent to hinder or delay creditors as required under the decisions to be established by clear, convincing and satisfactory evidence?

That the appellant, or more correctly as the record discloses, the Monidah Trust Company, conveyed the property to Alec Murray in 1912 is a conceded fact. There is no dispute that it was transferred to the bankrupt under a trust arrangement. On March 5th, 1917, Alec Murray deeded it back to appellant and the deed was placed on record. There was no concealment of such transfer. That appellant did not pay a substantial consideration for such deed is of no probative force for it is also true that under the trust arrangement Alec Murray paid nothing for the property, consistent with the understanding that that which was the subject of the trust during these years was, when the trust terminated, to be returned without consideration. It would be a distortion of the purposes of the bankruptcy act to contend that the trustor when the property was reconveyed should pay a "present fair consideration" for his own property. The trial court chides appellant for having done something which in its judgment was with respect to the rights of the State of Idaho "measurably reprehensible." But were such the fact that is something with which the State of Idaho is concerned; it does not remotely prove that the trust arrangement either at its inception or when it terminated was any part of a plan or scheme in which the appellant was a

party, with actual intent to defraud or by actual fraud "to hinder, delay or defraud the creditors of the bankrupt" which is the only issue herein. It was the duty of the bankrupt to reconvey and even had he done so at the request of appellant, such act is not adequate proof of the vital allegation, for he merely surrendered to the rightful owner that which belonged to him. It may be true as intimated by the authorities that the creditors sustained financial injury by reason of the conveyance to appellant which reduced the total amount of assets of the bankrupt to the extent of the value of the property—but this is not sufficient to establish the intent to defraud as defined by the decisions. As against the trustee in bankruptcy and the creditors of the bankrupt estate appellant did nothing that falls within the condemnation of the law and the evidence is insufficient to justify the decree of the lower court. Upon a review of the entire record herein, we confidently assert that it is manifest that the decree heretofore entered in the District Court of the United States, for the District of Idaho, was prejudicial to the rights of appellant and should be reversed.

Respectfully submitted,

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